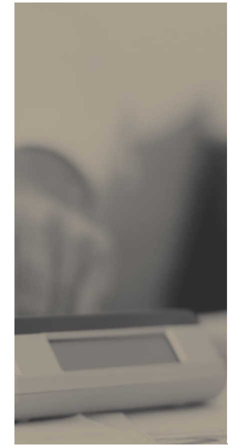
SOCIETY OF ACTUARIES

Article from:

Taxing Times

May 2009 – Volume 5 – Issue No. 2

INSURANCE TRANSFER PRICING: ISSUES FOR LIFE REINSURANCE TRANSACTIONS



By Christian DesRochers

Offshore reinsurance, particularly with affiliated reinsurers, is seen by tax authorities as creating the potential for tax avoidance. While this has historically been more in the context of property and casualty insurance, the increased number of transactions dealing with term insurance and secondary guarantee universal life under National Association of Insurance Commissioners (NAIC) regulations XXX and AXXX has increased the visibility of transfer pricing issues for life insurers.[1] In addition, FIN 48 has increased the awareness of the need to document and substantiate transfer pricing practices to tax authorities.[2] This article will describe the transfer pricing rules applicable to life reinsurance transactions generally, and then will outline a methodology for testing life reinsurance transactions to demonstrate compliance with transfer pricing standards applied by tax authorities.

TRANSFER PRICING DEFINED

When independent enterprises deal with each other, the conditions of their commercial and financial relationships (*e.g.*, the price of goods transferred) are governed by market forces. When associated enterprises deal with each other, their relationships may not be determined by market forces in the same way, but may be influenced by management or tax considerations. A transfer price is the price at which goods and services, financing, or intellectual property are transferred between related parties. That is, a transfer price is the monetary expression of a movement of goods or services between organizations of the same enterprise. Multinational enterprises ("MNEs") use transfer prices for the sale of goods and services within the corporate group. Transfer prices can be used to move profits, and taxes, between jurisdictions. From a tax perspective, transfer prices can be a significant element in determining the MNE's distribution of taxable income among the various tax jurisdictions in which it operates. As a consequence, it is therefore not surprising that tax authorities are concerned that the correct profit is attributed to economic activity in their jurisdiction, in order to collect the appropriate amount of tax attributable to the activity. Transfer pricing rules are intended to ensure the proper allocation of revenue between jurisdictions in which the entities are taxed.

In recent years, a firm's transfer pricing policy has emerged as a significant element of tax risk management. In their *2007-2008 Global Transfer Pricing Survey*, Ernst & Young commented:

> Tax departments are under increasing pressure to manage transfer pricing risks with greater precision, yet a rapidly developing regulatory environment, new enforcement tactics, and shifting fiscal policies make this even more complex to achieve. The degree of transparency in MNE's tax and transfer pricing provisions, largely driven by developments in financial and tax disclosure requirements, has dramatically increased in recent years.[3]

Further complicating the picture is the global trend toward international tax authority collaboration and information exchange. This increased scrutiny leads to increased compliance costs.

OECD TRANSFER PRICING STANDARDS

The international framework for economic analysis is set forth by the Organization for Economic Co-operation and Development ("OECD") in its 1995 publication *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ("OECD Guidelines"). The OECD endorses the arm's length principle as the basic rule governing the tax treatment of non-arm's length cross-border transactions. The arm's length principle is articulated in Article 9 of the OECD Model Tax Convention. This principle requires that, for tax purposes, taxpayers conduct their transactions with non-arm's length parties on the same terms and conditions that would have prevailed if the parties had been dealing at arm's length. That is, the arm's length transfer price should be comparable to the price for similar transactions between independent entities. The application of this principle ensures that a taxpayer that is a member of a multinational group and that engages in transactions with members of the group pays substantially the same amount of tax as it would have paid had the members of the group been dealing with each other at arm's

CONTINUED ON **PAGE 14**

length. The determination of whether a taxpayer has adhered to the arm's length principle is a question of fact.

Paragraph 1.13 of the OECD Guidelines notes: "The arm's length principle is sound in theory since it provides the closest approximation to the open market in cases where goods and services are transferred between associated enterprises." Paragraph 1.15 of the OECD Guidelines states that the application of the arm's length principle is generally based on a comparison of the prices or margins used or obtained by non-arm's length parties with those used or obtained by arm's length parties engaged in the same or similar transactions. In order for the price or margin comparisons to be useful, the economically relevant characteristics of the transactions being compared must be identical or at least sufficiently similar so as to permit reasonably accurate adjustments to be made for any differences in the characteristics of the transactions. The problem with the "arm's length" standard is that it only works well when comparable market prices are available. In some cases it may be possible to apply the arm's length principle to arrive at a single transfer price or margin which is used to determine whether a transaction is conducted at arm's length. However, this is generally not the case. Paragraph 1.45 comments that: "because transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable."

The principal method put forward by the OECD is the Comparative Uncontrolled Price Method ("CUP"), which looks toward the sale of the same or similar products to unrelated persons. An uncontrolled price is the price agreed upon between unconnected parties for the transfer of goods or services. If this transfer is in all material respects comparable to transfers between associates, then that price becomes a comparable uncontrolled price. The CUP compares the price charged for a property or service transferred in a controlled transaction with the comparable price in an uncontrolled transaction. There are two possible sources of a CUP. First, the taxpayer may sell the particular product in the same quantities, under the same terms and in the same markets to parties with whom it deals at arm's length (an internal comparable). Second, other taxpayers may sell the same product, in the same quantities, under the same terms and in the same markets, to arm's length parties (an exact comparable uncontrolled price). Where the information is readily available, the CUP method is the most direct and accurate method of checking transfer prices. As a result, the CUP method is preferred by OECD and most tax authorities.

The OECD Guidelines also outline other methods, which are characterized as traditional (transaction-based) or non-traditional (profit-based).[4] In terms of the traditional methods outlined by the OECD, the comparable uncontrolled price method, if applicable, will provide a higher degree of comparability than any of the other methods. Under the OECD Guidelines, the transactional profit methods may be used "in those exceptional circumstances in which the complexities of real life business put practical difficulties in the way of the application of traditional transaction methods."[5] While the ordering of the recommended methods is clear in theory, the lack of reliable information necessary to apply a particular method may require the application of a lower-ranking recommended method for which adequate information is available.

SECTION 482 TRANSFER PRICING RULES

The transfer pricing tax rules in the United States are set forth in Section 482 of the Internal Revenue Code and the related regulations.[6] Section 482 provides that "the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses." Thus, the standard to be applied by a MNE with respect to the United States is that the transaction as it is reported on a tax return "clearly reflects income." In 1968, the Treasury Department ("Treasury") published regulations that follow the "arm's length" standard.[7] Treasury Regulations 1.482-1(b)(1) provide that "the standard to be applied in every case is that of a

taxpayer dealing at arm's length with an uncontrolled taxpayer." Put differently, the arm's length standard is met if the results of a transaction are consistent with the results that would have been realized if unrelated taxpayers had engaged in a comparable transaction under comparable circumstances.[8]

In principle, the U.S. rules are very similar to the OECD Guidelines; however, a significant way in which the section 482 rules diverge from the OECD standards is in the choice of method. While the OECD rules imply a hierarchy, with the CUP method preferred, the arm's length result of a controlled transaction under section 482 must be determined under the "best method" rule. Regulations 1.482-1(c)(1) define this as the "method that, under the facts and circumstances, provides the most reliable measure of an arm's length result." Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. The Regulations also provide that "data based on the results of transactions between unrelated parties provides the most objective basis for determining whether the results of a controlled transaction are arm's length."[9] In determining which of two or more available methods (or applications of a single method) provides the most reliable measure of an arm's length result, the two primary factors to take into account are: (1) the degree of comparability between the controlled transaction (or taxpayer); and (2) any uncontrolled comparables, and the quality of the data and assumptions used in the analysis. While not following the OECD characterization of the profit-based measures as a "last resort," the Regulations also note that "an analysis under the comparable uncontrolled price method will generally be more reliable than analyses obtained under other methods if the analysis is based on closely comparable uncontrolled transactions, because such an analysis can be expected to achieve a higher degree of comparability and be susceptible to fewer differences than analyses under other methods."[10] At the same time, although the OECD rules generally favor transaction-based methods, the approach in the United States appears to be more heavily weighted toward profits-based methods.

SECTION 845(a) REINSURANCE RULES

Section 845 was enacted in 1984 and provides the Treasury the authority to reallocate items in a reinsurance arrangement to prevent the use of reinsurance as a tax avoidance device.[11] Section 845(a), dealing with related party transactions, was amended in 2004 to clarify that the Treasury Department had authority to allocate among the parties to a reinsurance agreement or to recharacterize income (or to make any other adjustment in order to reflect the proper source, character, or amount of the item.)[12] In clarifying that this authority included the amount (not just the source and character) of any such item, Congress expressed the concern that "reinsurance transactions were being used to allocate income, deductions, or other items inappropriately among U.S. and foreign related persons," and that "foreign related party reinsurance arrangements may be a technique for eroding the U.S. tax base."[13]

As amended, section 845(a) provides that the Secretary may—

(1) allocate between or among such persons income (whether investment income, premium, or otherwise), deductions, assets, reserves, credits, and other items related to such agreement,
(2) recharacterize any such items, or
(3) make any other adjustment,

if he determines that such allocation, recharacterization, or adjustment is necessary to reflect the proper amount, source, or character of the taxable income (or any item described in paragraph (1) relating to such taxable income) of each such person.

In principle, the U.S. rules are very similar to the OECD Guidelines; however, a significant way in which the section 482 rules diverge from the OECD standards is in the choice of method.

There is clear overlap between sections 845 and 482, as the "clear reflection of income" standard underlies both sections.

CONTINUED ON PAGE 16

The Internal Revenue Service ("IRS") is free to apply either or both sections with respect to reinsurance transactions. However, the transfer pricing penalties, as well as the broad application of the transfer pricing standards, may push the analysis to follow transfer pricing rather than the specific reinsurance-related provisions of section 845(a). In addition, the regulations under section 482 provide both taxpayers and the IRS with standards for determining if a transaction is in compliance with the arm's length standard, while regulations have not yet been issued under section 845.

TRANSFER PRICING FOR REINSURANCE TRANSACTIONS

A reinsurance contract is an agreement between an insurer (the ceding company or cedant) and a reinsurer. The insurer writes the underlying policy and is contractually responsible for any payments to the policyholders that come due under the policy, even if those insured risks are ultimately met by a reinsurer as part of a reinsurance contract. The insurer markets the policy, bears the costs of its sale and ongoing administration, and receives the premium income associated with the policy.[14] Under a typical coinsurance agreement involving inforce insurance, the initial reinsurance premium is equal to the reserve and the reinsurer pays the ceding company an allowance, called a ceding commission. The transaction is usually conducted on a net basis, with the ceding company transferring assets to the reinsurer that have a market value equal to the reinsurance premium less the ceding commission. Generally, the result is a net payment made by the cedant to the reinsurer. However, reinsurance contracts may, in certain market conditions, create a loss where ceding commission paid by the reinsurer does not cover the insurer's costs or where a negative ceding commission is paid to the reinsurer. In evaluating a reinsurance transaction under the transfer pricing rules, the two key questions would appear to be:

1. Can it be demonstrated that the ceding commission has been calculated on an arm's length basis?
2. Would the cedant have undertaken the transaction had it been with an independent reinsurer?

As previously noted, Section 482 requires that a taxpayer evaluate an intercompany transaction by applying the method that produces the most reliable measure of an arm's length transaction. In selecting the "best method," the Regulations note that the taxpayer must consider the following:

1. The availability of data to serve as an arm's length benchmark.
2. The reliability and completeness of the data that is available.
3. The quality of the assumptions required in order to apply the data.
4. The number and type of adjustments that need to be applied to the data to improve comparability.

The quality of the data and assumptions are important criteria in selecting the best method. The burden is on the taxpayer to show that the results under the method selected produces the most reliable result. In practice, there are a number of approaches that can be used to evaluate inter-group reinsurance transactions. However, all of these are based to some degree on an actuarial pricing approach, but have been character-

ized in different ways based on the way in which the analysis was presented. The methods include a direct or indirect CUP and the comparable profits method ("CPM"), known as the transaction net margin method ("TNMM") under the OECD Guidelines. The section 482 regulations also provide for so-called "unspecified methods," using as an arm's length result the price that would have been realized in an independent alternative to the controlled transaction. Perhaps the most accurate characterization of an actuarial method is an unspecified method under section 1.482-3(e) of the Regulations.

Determination of the Comparable Uncontrolled Price

The CUP method for tangible property (and the related Comparable Uncontrolled Transaction Method ("CUT") for intangible property) evaluates whether the price charged in a controlled transaction is arm's length by reference to the amount charged in a similar uncontrolled transaction under the same circumstances.[15] That is, under the CUP approach it is necessary to establish if a comparable transaction exists in the marketplace between unrelated parties. Clearly, the CUP method works best in circumstances where an affiliated company operates in a competitive market where comparable prices are readily observable. If there are differences between the controlled and uncontrolled transactions that would affect price, adjustments should be made to the price of the uncontrolled transaction according to the comparability provisions of Regulations 1.482-1(d)(2). As discussed below, the CUP can be very difficult if not impossible to apply in practice to reinsurance because of the lack of truly comparable transactions, as there is no actively traded market for insurance liabilities.

Reinsurance pricing follows the same principles as traditional insurance pricing, as the reinsurance actuary must evaluate the plan in terms of the anticipated experience of the ceding company. Further, an actuarial appraisal value or other projection of the future cash flows or distributable earnings of a block of business will produce a unique value based on the product and risk characteristics of the policies making up the block of business. It is therefore impossible to treat reinsurance as a commodity, for which a standard price can be set, or for which a benchmark market price can be calculated. A common statement made in support of the arm's length nature of inter-company reinsurance transactions is that "inter-company transactions are priced on exactly the same basis as for external reinsurance."[16] To use this to establish the validity of a transaction under the CUP, there should be a sufficient record to support that such a policy exists and internal controls to ensure the implementation of the policy. One possible advantage of this approach is that, to the extent that it can be shown that the same pricing models and methodologies are applied for both internal and external reinsurance pricing, multiple transactions might be supported and documented on this basis. Establishment of a CUP for reinsurance may also be possible if the insurer has purchased the same reinsurance coverage externally in the recent past or a third-party reinsurer shares the same terms as the related reinsurer, as a co-reinsurer or retrocessionaire. If the ceding company reinsures comparable business in the open market, then it may be appropriate to use the ceding company's reinsurance pricing model to establish a comparable price as an indirect CUP.

> A common statement made in support of the arm's length nature of inter-company reinsurance transactions is that "inter-company transactions are priced on exactly the same basis as for external reinsurance."[16]

Alternatively, a modified or indirect CUP approach to generate an arm's length price for a reinsurance transaction looks to the price at which an insurer would be prepared to assume the liabilities being ceded, if this business were offered by a third-party external insurer. It may be possible, by the use of an actuarial pricing model, to demonstrate that the pricing of the related-party business is similar to the pricing of the external business. This may require that the insurer have a presence in the reinsurance market to justify the pricing of third-party transactions. Regulations

CONTINUED ON PAGE 18

1.482-3 (b)(5)(i) note that indirect evidence of a comparable uncontrolled price may be derived from data from public exchanges or quotation media, but only if the data is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled sales; and the data derived from public exchanges or quotation media is used to set prices in the controlled transaction.

A more direct approach is to simply characterize the actuarial method as an "unspecified method."[17] Regulations 1.482–4(e) provide an "unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of a transaction by considering the realistic alternatives to that transaction, and only enter into a particular transaction if none of the alternatives is preferable to it." This would allow the appraisal methodology to be applied on its merits, without trying to characterize it as a direct or indirect CUP. An actuarial appraisal methodology (the approach ordinarily employed to assess the overall financial soundness of a U.S. insurer) is an appropriate measure of an uncontrolled price to determine whether reinsurance transactions between affiliates are conducted on an arm's length basis.[18] An alternative to a specific reinsurance model would be to develop data and assumptions from the Actuarial Opinion and Memorandum filed with state regulatory authorities relative to the policies being reinsured.[19]

Determination of the Comparable Profit

The comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.[20] The comparable profits method is applied by first developing a sample of financial data, or profit level indicators ("PLI"), from companies that are seen as similar to the tested company. These are applied to the determination of an arm's length result by comparing the operating profits that result from related party transactions with the profits of an uncontrolled comparable (comparable operating profit) based on the profit level indicator. Comparable operating profit is calculated by "determining a profit level indicator for an uncontrolled comparable, and applying the profit level indicator to the financial data related to the tested party's most narrowly identifiable business activity for which data incorporating the controlled transaction is available (relevant business activity)."[21]

Comparability under the CPM is dependent on the similarity of invested capital and risks assumed under comparable affiliate and non-affiliate transactions. However, the CPM requires that the simpler entity in the transaction be the "tested" party to be evaluated. The analysis under the CPM is based on PLIs, including the rate of return on capital employed, or financial ratios which measure relationships between profit and costs or sales revenue.[22] In practice, the CPM could be applied to a reinsurance transaction by comparing the return under the reinsurance agreement with the return on equity or the return on assets of comparable insurance or reinsurance companies over comparable periods of time.

Development of Transfer Pricing Documentation

In analyzing a reinsurance transaction, one approach to developing transfer pricing documentation to determine whether the pricing of a reinsurance transaction has been arm's length based on an actuarial appraisal methodology (as an unspecified method) supported by a CPM analysis using published financial data of comparable companies. The analysis would consist of the following broad activities:

1. Review the factual information regarding the acquisition including the reinsurance agreement and any actuarial appraisals that may have been made in connection with the transaction.
2. Validate the actuarial appraisal method as the "best" method under section 482.
3. Generate an actuarially determined range of values for the ceding commission based on the data and assumptions in the actuarial appraisal or the most recent AOMR that covers the business under the agreement.

4. Compare the ceding commission to the arm's length actuarially determined values.
5. Determine the comparable companies for the CPM validation.
6. Identify and compute the relevant PLIs for the CPM analysis and compare to the transaction-generated values.

In doing the analysis described here, it may not be possible to calculate in advance the precise price at which a reinsurance transaction will be concluded. However, the economic value is the underlying basis for the price paid, where value is defined as the economic value or range of economic values derived using an actuarial appraisal. As with any actuarial exercise, the setting of the assumptions is one of the most difficult tasks of an actuarial appraisal, requiring considerable judgment and expertise.

CONCLUSION

Insurance companies, particularly life insurers, have traditionally not seen transfer pricing as a major area of concern. Tax issues related to reinsurance have dealt more with the presence or absence of risk, and not the price at which the transaction takes place. However, that view is changing in the face of the increasing globalization of the life insurance industry. From the perspective of the tax authorities, the transfer pricing calculation determines the profits of a business that are subject to tax in a given jurisdiction. Increasingly authorities in the United States and overseas are scrutinizing transactions to assure that the arm's length standard is met. This is particularly the case where large amounts of business are ceded, the ceded business is highly profitable, or the nature of the risk is such that similar transactions from which to develop comparables are not likely to be readily available. Transfer pricing documentation of affiliated reinsurance is an exercise that can involve actuaries, accountants, and attorneys. However, it is an art not a science, and there are significant penalties that can be imposed for the failure to follow and document the arm's length nature of a reinsurance agreement. ◄

END NOTES

[1] For at least a decade, the reserve standards articulated in *The Valuation of Life Insurance Policies Model Regulation* (commonly referred to as Regulation XXX or National Association of Insurance Commissioners (NAIC) Model Regulation 830) and more recently, Actuarial Guideline 38, *The Application of the Valuation of Life Insurance Policies Model Regulation* (commonly referred to as AXXX) have been the subject of controversy within the life insurance industry.

[2] FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes.*

[3] *Precision under pressure – global transfer pricing survey 2007-2008,* Ernst & Young, 4.

[4] There are 5 transfer pricing methods described in the OECD Transfer Pricing Guidelines. These are characterized as transaction-based and profit-based methods. The traditional methods (transaction-based) are: 1. Comparable uncontrolled price method; 2. Cost-plus method; and 3. Resale price method. The non-traditional methods (profit-based) are: 1. Profit split method; and 2. Transactional net margin method. The profit-based methods are based on comparisons of profit rates or margins as a means to estimate the profits that one or both members of an associated enterprise could have earned had they dealt solely with independent enterprises. Methods based on profits are acceptable only to the extent that they are compatible with Article 9 of the OECD Treaty. This is achieved by applying the methods in a manner that approximates arm's length pricing. That is, the profits from controlled transactions are compared to profits arising from comparable transactions between unrelated parties.

[5] The OECD approved the profit split method and the transactional net margin method as "methods of last resort" in 1995. Since that time, however, there has been increasing pressure on the OECD to give broader recognition to the profit-based methods given their wide application.

[6] IRC section 1060 applies to reinsurance transactions where the purchaser acquires significant business assets in addition to the insurance contracts. In that case, the regulations under section 338 may override the usual section 482 regulations for reinsurance. *See* Mark H. Kovey and Lori J. Jones, "Highlights of the Recent Guidance on Insurance Company Acquisitions," *TAXING TIMES,* September 2006.

[7] The regulations were modified in 1994 to add profit-based measures.

[8] However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.

[9] Regulations 1.482-1(c)(2).

[10] Regulations 1.482-1(c)(2)(i).

[11] Conference Report to H.R. 4170, The Deficit Reduction Act of 1984, H. Rep. No. 98-861 (June 23, 1984), 1060. Section 845(a) deals with affiliates, while section 845(b) deals with non-related party reinsurance. *See Trans City Life Insurance Company v. Comm'r*, 106 T.C. 274 (1996), non-acq., 1997-2 C.B. 1, Nov. 3, 1997 for a discussion of issues related to non-affiliated reinsurance under section 845(b).

CONTINUED ON **PAGE 20**

Christian DesRochers, FSA, MAAA, is a senior managing director, Life Actuarial Services with SMART Business Advisory and Consulting, LLC and may be reached at *cdesrochers@smartgrp.com.*

END NOTES (CONTINUED)

[12] Section 803 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357.

[13] *See* Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress*, JCS-5-05, May 2005, 351.

[14] Although some reinsurance transactions may also include a transfer of administration of the policies to the reinsurer.

[15] In July 2006, the Treasury issued Temporary Regulations related to intra-group services. The regulations identified a "black list," which included insurance and reinsurance, of types of services that could not be charged at cost.

[16] *Transfer Pricing Key Issues: Reinsurance: a transfer pricing 'hot topic,'* Financial Services Transfer Pricing Perspectives, PricewaterhouseCoopers LLP, February 2008, 9.

[17] Regulations 1.482-4(d)(1). Regulations 1.482-4(d)(2) appears relevant to reinsurance as it provides an example which relates an arm's length price to the profit a related party would have earned if it carried out the transaction itself rather than licensing it to a subsidiary.

[18] Actuarial Standard of Practice No. 19 (ASOP 19), *Appraisals of Casualty, Health, And Life Insurance Businesses*, is effective for all appraisals of casualty, health, and life insurance businesses initiated on or after November 1, 2005. For insurance transactions, the generally accepted method of analysis is an actuarial appraisal. Actuaries perform appraisals for a number of purposes and for a variety of users, including sellers, buyers, management, and regulators. Actuaries perform appraisals of insurance businesses of various types using a variety of methods. In some cases, appraisals performed by actuaries show values that are discounted present values of earnings, distributable earnings, or other amounts. An actuarial appraisal is a specific type of appraisal. The key distinguishing feature of an actuarial appraisal is the projection of the future stream of distributable earnings attributable to the evaluated business based on the applicable regulatory accounting basis. This stream of earnings includes the runoff of claim liabilities and other liabilities carried on the balance sheet at the valuation date as projected using actuarial assumptions relating to items such as mortality, persistency, expenses, and investment return. The projections may be done for existing and new business separately or in combination. The projected earnings are then discounted at the selected discount rate(s) to derive the actuarial appraisal value.

[19] NAIC Model Regulation 822, entitled *Actuarial Opinion and Memorandum Regulation* requires all life insurance companies and fraternal benefit societies to submit actuarial opinions based on an asset adequacy analysis.

[20] As described in the OECD Guidelines, the TNMM compares the net profit margin of a taxpayer arising from a non-arm's length transaction with the net profit margins realized by arm's length parties from similar transactions. A net margin method uses margins computed after operating expenses. An issue that arises with the TNMM is that the method is typically applied to only one of the associated enterprises. While the resale price and cost-plus methods are also one-sided, the fact that there are many factors that enter into the calculation of the net margin may implicitly leave other members of the group with unusually high (or low) profit levels. As a result, Paragraph 3.45 of the OECD Guidelines indicates it is "important to take into account a range of results when using the transactional net margin method."

[21] Regulations 1.482-5.

[22] The rate of return on capital employed is the ratio of operating profit to operating assets. The reliability of this profit level indicator increases as operating assets play a greater role in generating operating profits for both the tested party and the uncontrolled comparable. In addition, reliability under this profit level indicator depends on the extent to which the composition of the tested party's assets is similar to that of the uncontrolled comparable.

RESERVESWEEK

JUNE 1–4
CHICAGO MARRIOTT SUITES O'HARE
ROSEMONT, IL

INVOLVED IN FINANCIAL REPORTING AND PRODUCT DEVELOPMENT?
Just starting out in your profession or need a refresher in statutory, tax or GAAP valuations?

Then Bring On the Reserves! Because **RESERVES**WEEK has been specifically designed for you! **Join us** in Chicago for four intense days bankrolling your knowledge in statutory, tax and GAAP valuation.

Register today at ***www.soa.com***

Actuaries
Risk is Opportunity.®